

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Haynes Analyst: Jane Tolman Bill Number: SB 1274
Related Bills: See Legislative History Telephone: 845-6111 Introduced: January 15, 2002
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Attorney, Physician, Surgeon Services At No Charge For Nonprofit Charitable Organization Credit

SUMMARY

This bill would allow a credit for voluntary services provided by an attorney, physician, or surgeon on behalf of any nonprofit charitable organization located in this state that helps the poor.

PURPOSE OF THE BILL

The author's staff has indicated that the purpose of this bill is to provide a tax incentive to attorneys, doctors, and surgeons to donate their services to nonprofit organizations.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. This credit would be operative for taxable years beginning on or after January 1, 2002, and does not contain a sunset date.

POSITION

Pending.

Summary of Suggested Amendments

The department is willing to assist with amendments to address the concerns below.

ANALYSIS

FEDERAL/STATE LAWS

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Current federal and state laws allow a deduction for contributions made to certain charitable organizations. Neither state nor federal law currently provides a credit or a deduction for the value of services donated to a charitable organization.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

02/19/02

THIS BILL

This bill would allow a credit equal to the fair market value of services provided without charge by an attorney, physician, or surgeon. The attorney, physician, or surgeon must be licensed to practice in this state. These services must be performed for or on behalf of any nonprofit charitable organization located in this state that provides services to the poor.

Any excess credit could be carried over until exhausted.

This bill also specifies that no deduction would be allowed for any services for which the credit was allowed.

IMPLEMENTATION CONSIDERATIONS

This bill uses terms that are undefined, i.e., "physician," "surgeon," "poor," and "fair market value of services." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of the credit.

This bill provides a credit for services for or on behalf of any "nonprofit charitable organization" that provides services to the poor. A definition that clarifies whether the organization receiving the services must be tax-exempt under existing state law, preferably with a reference to the section, under which it must be exempt, would be helpful.

It would be helpful if the bill imposed a requirement upon the nonprofit charitable organization to provide a receipt to the lawyer, surgeon, or physician specifying the number of donated hours, and if the professional would be required to provide the receipt to the department upon request. This requirement would enable the department to verify the amount of the credit claimed.

LEGISLATIVE HISTORY

AB 1689 (Statham, 1993/1994) would have allowed a \$5,000 credit to certain health care practitioners who served in "health professional shortage areas." This bill failed to pass out of the first house.

AB 1172 (Frusetta, 1999/2000) would have allowed a 25% tax credit for the taxpayer's expenses for preventive health care provided to farm workers. This bill failed to pass out of the first house. SB 1416 (Rainey, 1999/2000), would have allowed a physician or surgeon to claim a 100% tax credit for the amount that otherwise would be reimbursed by the Medi-Cal program for their services. This bill died in the Governmental Organization Committee.

SB 846 (Ackerman, 2001/2002) would have allowed a credit for free services provided by an attorney, physician, surgeon, dentist, or optometrist on behalf of any nonprofit charitable organization that helps the poor. This bill died in the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found no comparable tax credits. These states were reviewed because of similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill is estimated to impact revenue as shown in the following table.

SB 1274, As Introduced January 15, 2002 Fiscal Year Cash Flow Taxable Years Beginning After December 31, 2001 Enactment Assumed After June 30, 2002 \$ Millions		
2002-03	2003-04	2004-05
-\$155	-\$220	-\$225

Note: Estimates above have been rounded to the nearest \$5 million. Since fair market values can represent subjective judgments, this bill could lead to significant abuse and even larger revenue losses.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

The revenue estimates above were initially calculated on a tax year liability basis and then converted to fiscal year, cash-flow projections (July 1-June 30). The latter estimates take into account the timing changes to withholding and estimated taxes paid throughout the year by taxpayers affected by the proposal as well as changes to year-end tax payments and refunds.

Revenue Discussion

The revenue impact for this bill will be determined by the fair market value of uncompensated services provided by physicians, surgeons and attorneys, and the tax liabilities of those claimants. This analysis assumes that no compensation whatsoever can be received by those professionals for donated services.

Physicians and Surgeons

According to the 1999 U.S. Statistical Abstract, there were approximately 78,502 physicians and surgeons in California for 1997. This number was grown by Consumer Price Index (CPI) projections, yielding approximately 90,919 for 2002.

For this analysis, it was assumed that the average income tax liability for physicians and surgeons who would take the credit would be approximately \$10,000 (average income of \$200,000 x .05 average marginal tax rate). Further, it was assumed that physicians and surgeons who participate could greatly reduce or eliminate their tax liability by using this credit, leaving a minimum amount of unused credits to future years.

Based on the major incentive effect of allowing a 100% tax credit (despite the loss of compensation), it was assumed that in the first year, 10% of physicians and surgeons would reduce or eliminate their state taxes, generating a loss of \$91 million for tax year 2002. The first-year estimate is less than later years due to an assumed enactment date after June 30, 2002.

For 2002 and thereafter, it was assumed that approximately 20% would reduce or eliminate their state tax liability, generating a loss of \$185 million for 2003. Losses were grown by CPI projections and adjusted for deductions that would have otherwise been allowed under current law (i.e. material costs).

Attorneys

According to the American Bar Association, there are approximately 137,803 active attorneys in California as of March 1, 2001. This number was grown by CPI projections, yielding approximately 139,388 for 2002.

For this analysis, it was assumed that the average income tax liability for attorneys who would take the credit would be approximately \$7,500 (average income of \$150,000 x .05 average marginal tax rate). Further, it was assumed that attorneys who participate could greatly reduce or eliminate their tax liability by using this credit, leaving a minimum amount of unused credits for future years.

Based on the major incentive effect of allowing a 100% tax credit (despite the loss of compensation), it was assumed that in the first year 2.5% of attorneys would reduce or eliminate their state taxes, generating a loss of \$26 million for tax year 2002. The first-year estimate is less than later years due to an assumed enactment date after June 30, 2002.

For 2002 and thereafter, it was assumed that approximately 5% would reduce or eliminate their state tax liability, generating a loss of \$53 million for 2003. Losses were grown by CPI projections and adjusted for deductions that would have otherwise been allowed under current law (i.e. material costs).

Fiscal year estimates above allow for the fact that some taxpayers can accelerate the tax benefit by reducing state withholding and/or estimated tax payments during the tax year.

ARGUMENTS/POLICY CONCERNS

Credits generally are provided as a percentage of the taxpayer's actual expenses. This bill would allow a 100% credit for the taxpayer's donated services, which is unprecedented.

This bill does not specify a repeal date or limit the number of years for the carryover period. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, even if a repeal date were added, the department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover limitation since experience shows credits are typically used within eight years of being earned.

LEGISLATIVE STAFF CONTACT

Jane Tolman
Franchise Tax Board
845-6111

Brian Putler
Franchise Tax Board
845-6333